COUNTY OF LOS ANGELES
DEPARTMENT OF AUDITOR-CONTROLLER

KENNETH HAHN HALL OF ADMINISTRATION
500 WEST TEMPLE STREET, ROOM 525
LOS ANGELES, CALIFORNIA 90012-2766
PHONE: (213) 974-8301 FAX: (213) 626-5427

J. TYLER McCAULEY
AUDITOR-CONTROLLER

May 9, 2003

TO: Supervisor Yvonne Brathwaite Burke, Chair
Supervisor Gloria Molina
Supervisor Zev Yaroslavsky
Supervisor Don Knabe
Supervisor Michael D. Antonovich

FROM: J. Tyler McCauley
Auditor-Controller

SUBJECT: **SHERIFF BUDGET AUDIT INTERIM REPORT**

In June 2002, the Board instructed the Auditor-Controller to contract out for a review of the County's budget practices related to the Sheriff's Department (Sheriff), including how the County budgets salary savings for the Sheriff and the District Attorney (DA). Attached is the consultants (Thompson, Cobb, Bazilio, and Associates and Altmayer Consulting, Inc.) interim report.

The interim report addresses the Chief Administrative Office's (CAO's) budget development and monitoring procedures and the CAO's salary savings calculations for the Sheriff and DA.

Summary of Interim Report

The report indicates that the CAO has fairly applied its Budget Instructions in developing the Sheriff Department budget. However, the consultants noted that the Sheriff's budget did not accurately forecast actual expenditures, nor was the budget amended during the year to reflect actual spending patterns, resulting in significant year-end variances. They have recommended that the CAO and Sheriff work collaboratively to ensure that the budget more accurately predicts actual expenditure patterns. The report indicates that the CAO and Sheriff have begun this process.

The consultants also noted that, in regards to salary savings, both the Sheriff's and District Attorney's budgets contained significant numbers of unfunded positions and the salary savings component of the budgets were artificially inflated to balance the budget with available funding. They have recommended that the CAO and departments identify and eliminate positions that have been held vacant to fund the inflated salary savings and that the salary savings be based upon historical data for the actual number of positions expected to be filled these.

The above findings are consistent with previous Auditor-Controller reviews of the Sheriff budget. The consultant's report which discusses these and other findings is attached. The CAO's response which indicates general agreement with the findings is also attached. The District Attorney's response, also attached, criticizes the consultant for not finding a financial solution to fund the unfunded positions. However this is far outside the scope of the consultant's assignment and they were never expected to do so. The Sheriff indictated they will respond when the final report is issued.

The consultant's final report, which will focus on the Sheriff's internal budget process, is expected to be issued next month.

If you have any questions, please contact me or have your staff contact DeWitt Roberts at (626) 293-1101.

JTM:DR:MP
Attachment

c: David E. Janssen, CAO
Leroy D. Baca, Sheriff
Steve Cooley, District Attorney
Lloyd W. Pellman, County Counsel
Violet Varona-Lukens, Executive Officer
Public Information Officer
Audit Committee

LOS ANGELES COUNTY AUDITOR-CONTROLLER

Los Angeles County Sheriff's Department Budget Process Study

Interim Report
CAO Budget Process Review

May 2003

Submitted by

TCBA and Altmayer Consulting, Inc.

THOMPSON, COBB, BAZILIO & ASSOCIATES, PC

21250 Hawthorne Blvd. Suite 500 Torrance, CA 90503

PH 310.792.7001 . FX 310.792.7004 . www.tcba.com

THOMPSON, COBB, BAZILIO & ASSOCIATES, PC

Certified Public Accountants and Management, Systems, and Financial Consultants

21250 Hawthorne Boulevard
Suite 500
Torrance, CA 90503
310 792-7001
310 792-7004 Fax

1101 15th Street, N.W.
Suite 400
Washington, DC 20005
202 737-3300
202 737-2684 Fax

100 Pearl Street
14th Floor
Hartford, CT 06103
203 249-7246
203 275-6504 Fax

May 9, 2003

Mr. J. Tyler McCauley
County of Los Angeles Auditor-Controller
500 West Temple Street, Room 525
Los Angeles, CA 90012-2766

Dear Mr. McCauley:

Thompson, Cobb, Bazilio & Associates, PC (TCBA) and Altmayer Consulting, Inc. are pleased to present this interim report on our study of the budget process used by the CAO to manage the Sheriff Department's budget. This interim report discusses findings and recommendations on the following: (1) the CAO budget development process and the consistency in applying those practices to the Sheriff's budget, (2) the methods used by the CAO to monitor the Sheriff's budget, and (3) the methodology used to calculate "salary savings" for both the Sheriff and District Attorney.

Our study of the Sheriff's budget process, the Sheriff's budget performance, and the contract city billing model is continuing and will be presented in a final report in June 2003. We will also continue to evaluate the methods and practices being employed by the CAO in the development and monitoring of the Sheriff's budget. This further work will include integrating findings and recommendations regarding the Sheriff's budget process with those applicable to the CAO.

We would like to thank CAO management and staff for their cooperation and efforts in assisting us in this very important budget study.

Respectfully,

Michael J. deCastro

Michael J. deCastro
Principal

A Professional Corporation

TABLE OF CONTENTS

I. EXECUTIVE SUMMARY

During the past five years, the Los Angeles County Sheriff Department's (Sheriff) budget contained significant budget variances, which on two occasions, resulted in an over-expenditure at the end of the fiscal year. Based on direction from the Board of Supervisors, the Auditor-Controller directed this study to audit the following:

(1) The Chief Administrative Office's (CAO) budget methods and practices as they relate to the Sheriff's budget
(2) The Sheriff's budget process
(3) The Sheriff's budget performance, and
(4) The contract city billing model utilized by the Sheriff to obtain reimbursement for contracted services

This interim report focuses solely on the first aspect of the study: the budget process used by the CAO to manage the Sheriff's budget. This interim report makes findings and recommendations on the following: (1) the CAO budget development process and the consistency in applying those practices to the Sheriff's budget, (2) the methods used by the CAO to monitor the Sheriff's budget, and (3) the methodology used to calculate "salary savings" for both the Sheriff and District Attorney.

Results in Brief

During the five-year audit period, the CAO budget development and management process related to the Sheriff contained weaknesses in its application. During the audit period, the Sheriff's budget contained large variances within the major spending categories of Salaries and Employee Benefits (S&EB) and Services and Supplies (S&S). In FY2000-01, the failure to control spending resulted in an over-expenditure at the Sheriff summary level at the end of the fiscal year.

Beginning in FY2002/03, the CAO made noticeable improvements in their budget development and management practices as they relate to the Sheriff's budget. Those improvements included a restructuring of the Sheriff's budget. While this effort was a necessary first step to resolve the existing variance issues, a long term restructuring of the CAO budget process is necessary to prevent these issues from recurring.

The recommendations of this interim report focus on changing the budget process as it relates to the Sheriff's budget until all the other County departments are reviewed, to ensure the development of an accurate budget that, where necessary, is adjusted to represent changed priorities or programs.

The recommendations also focus on revising the overall budget process to build a more strategic budget to address current and future financial uncertainties.

The following represents an overview of the study's findings and recommendations:

Finding 1: The study team found that the CAO fairly applied its budget instructions in developing the Sheriff's Department budget.

Finding 2: During the audit period, the Sheriff's budget did not accurately forecast actual expenditures, nor was the budget amended during the fiscal year to reflect actual expenditures, resulting in significant year end variances.

In FY2000/01, the Sheriff significantly overspent its budget, largely as a result of a variance within its S&EB costs. The overage was symptomatic of two weaknesses within the CAO's budget process. First, the Sheriff's proposed budget did not accurately reflect anticipated expenditures within appropriation categories or within the level two budget units.[1] And second, during a fiscal year when it became apparent that significant variances would occur, little or no corrective action was taken to amend the budget to reflect the expenditure trends.

> ***Recommendation 1*:** The CAO should work collaboratively with the Sheriff to ensure that their budget more accurately predicts actual expenses within level two budget units.
>
> The CAO and the Sheriff began a process to realign the Sheriff's budget in FY2002/03. The resulting budget corrected the imbalance that occurred within the major categories of S&EB and S&S. The CAO and Sheriff, however, must continue in future budget years to ensure that expenses are properly budgeted in the level two budget units. As part of this effort, the CAO and the Sheriff must work to eliminate unfunded positions and over-hires in order to better reflect actual staffing levels.
>
> ***Recommendation 2:*** The CAO should continue its efforts to explicitly quantify and highlight the impacts of anticipated expense components of significant growth.
>
> The multi-year forecast provides an effective mechanism to anticipate the County's financial position over the mid-term. The forecast projects both revenue and cost increases associated with some program changes and personnel costs on the General Fund. The CAO is in the process of expanding the scope of the cost factors to be projected (e.g., retiree health and workers' compensation) and these costs will be quantified and highlighted in the FY2003/04 proposed budget and included in the next multi-year forecast. The CAO should continue these efforts and be recognized for the progress made to date.

---

[1] A level one budget unit is the Department as a whole, whereas level two budget units are divisions, bureaus, or programs within the Department.

Finding 3: During the audit period, the budgets for the Sheriff and District Attorney overstated the number of positions available to be filled during the course of the fiscal year. The salary savings component of the budgets was artificially inflated to balance S&EB costs.

Salary savings is intended to capture the cost savings associated with predictable salary adjustments (e.g., step increases) and routine vacancies. In the case of the Sheriff's Department and the District Attorney's Office, salary savings has been artificially increased in order to offset an unfinanced increase in budgeted positions. The result has been that both the Sheriff and the District Attorney held certain positions "permanently" vacant to achieve their salary savings target.

> ***Recommendation 3:*** The CAO should adopt a more objective methodology for calculating salary savings and mandate that departments more accurately state budgeted positions they reasonably anticipate filling during the budget year.
>
> Specifically, the CAO should (1) require that the vacancy factor element of salary savings be based on historical vacancy data and objective hiring delay factors, and (2) require that departments identify and eliminate positions that have been historically held vacant to "fund" the inflated salary savings.

Finding 4: During the audit period, the CAO used a baseline budget approach in developing the departmental budgets. In light of continuing economic instability, this approach may no longer be compatible to address future financial realities.

The CAO requires that departmental budgets be prepared using a baseline budget approach. Departments develop their budget using the prior year budget plus the additional costs associated with programmed expenditures such as negotiated S&EB increases. Additional costs associated with program expansion or service delivery changes must be requested and are considered separately as a "critical need." With current economic conditions, it is becoming increasingly difficult to continue to fund programs and services at historical levels without restructuring County expenditures. The baseline budget model currently being used by the CAO makes it difficult for the County to systematically identify and implement program restructuring.

> ***Recommendation 4:*** The CAO should continue its efforts to more fully integrate and align strategic planning and performance measurement within the budget process.
>
> The CAO should work to build a more strategic budget process that closely aligns strategic planning and performance measurement to resource decisions. The County began to move in the direction of integrating performance measures with the budget process starting with the departments participating in the Children's budget. The budget process continues to operate outside of this framework and is relying on incremental budgeting (or base budgeting) without critically examining the cost of programmatic base assumptions.

Recommendation 5: The CAO should evaluate the effect of changes to the revenue management strategies for the expenditure of Proposition 172 funds. The County should consider alternatives being incorporated by other counties to enhance revenue management strategies for the use of Proposition 172 funds. Two of the peer counties interviewed pursuant to this study have implemented cost management incentives for utilizing Proposition 172 funds.

II. INTRODUCTION

The CAO is responsible for preparing budget and operational recommendations to the Board of Supervisors (Board) and for monitoring countywide expenditures and revenues. This responsibility is balanced by the role of individual departments to prioritize and implement programs and services within the parameters of countywide budgetary limitations. This balance is especially fragile where elected officials who manage departments have the additional mandate of serving their constituency.

Based on direction from the Board, the Auditor-Controller directed this study to conduct a review of the current budget process as it relates to the Sheriff.

Study Objective

The objective of this study is to assess the adequacy of and make recommendations relating to the following:

(1) The CAO budget methods and practices as they relate to the Sheriff's budget

(2) The Sheriff's budget process

(3) The Sheriff's budget performance, and

(4) The contract city billing model utilized by the Sheriff to obtain reimbursement for contracted services

This interim report contains the study team's findings and recommendations regarding the first study objective: the CAO budget methods and practices as it relates to the Sheriff's budget. This interim report makes recommendations on the following:

- The CAO budget development practices and the consistency in applying those budget methods and practices as they relate to the Sheriff
- The methods used by the CAO to develop and monitor the Sheriff's budget
- The methodology used to calculate "salary savings" for both the Sheriff and District Attorney as well as countywide

It is important to note that the findings and recommendations contained within this interim report are limited to the CAO budget process as it relates to the Sheriff's budget. As such, the findings and recommendations are preliminary pending further review by the study team of both the Sheriff's budget process and any additional review and analyses of the CAO budget process. The final report will contain a more complete analysis of an integrated budgetary approach that will involve changes to both the CAO and the Sheriff's budget processes.

Approach and Methodology

Task I: Comprehensive review of background materials – The study team reviewed background materials by the CAO, the Sheriff, the Auditor-Controller and the District Attorney. The materials included historical budget data, past and current budget instructions, financial reporting documents, applicable County policies and procedures, prior audit reports relating to the Sheriff and CAO budget process, and memoranda addressing budget issues between the CAO and the Sheriff. The specific time period reviewed by this audit is five years, although some documentation beyond that time period was reviewed to provide adequate historical context.

Task II: Meetings with County Staff – The study team met with CAO Budget staff concerning the existing budget process, historical budget issues related to the Sheriff and recent changes made to the budget process. Meetings with CAO staff also focused on the County's approach to budget forecasting and practices related to calculating salary savings. Additionally, the study team met with representatives from the Auditor-Controller's Office and the District Attorney's Office to discuss issues ranging from budget adjustment policy to salary savings. See Appendix A for a list of contacts made to date.

Task III: Peer Review – The study team conducted a peer review of the budget methods and practices being utilized by a sampling of local counties. The purpose of the interviews was to review and evaluate how those counties budget for and fund law enforcement services. The study team met with administrative, budget and/or sheriff representatives from San Diego, Orange and San Bernardino Counties.

Task IV: Formulation of Preliminary Findings and Recommendations – Incorporating the work performed in the above tasks, the study team prepared preliminary findings and recommendations relating to the CAO budget process. This interim report presents those findings and recommendations.

Task V: Next Steps – Consistent with the scope of work identified in the RFP, work on the Sheriff's budget process, the Sheriff's budget performance and the contract city billing model is continuing and will be presented in a final report in June of 2003. The study team will also continue to evaluate and make recommendations on the methods and practices being employed by the CAO in the development and monitoring of the Sheriff's budget. This further work will include, if necessary, integrating findings and recommendations regarding the Sheriff's budget process with those applicable to the CAO.

Background

Overview of CAO Budget Process

The County's budget process begins in the fall prior to the subsequent July 1 fiscal year start date. The CAO drafts and distributes departmental budget instructions to all departments and agencies. The budget instructions provide comprehensive directions to departments regarding the financial, narrative and position requirements for budget submissions, including:

- ❑ CAO revenue and expenditure projections and any required methodologies for developing specific components
- ❑ Narrative submission requirements, including development and reporting of performance measures and data
- ❑ Position and classification instructions per the Department of Human Resources (DHR) instructions, submission requirements in regards to technology funding per the Chief Information Officer (CIO) and specific instructions related to the "Children's Budget"

During the period of budget development, the CAO, DHR and CIO conducted joint budget training sessions for departments and highlighted major changes to the budget requirements and budget forms, as well as review ongoing requirements.

The CAO is also responsible for developing a multi-year forecast detailing revenue and expenditure assumptions over a three-year period. The forecast addresses general purpose (e.g., Vehicle License Fees, property taxes, sales tax, etc.) and specific purpose (e.g., Realignment, Prop 172, etc.) County funding sources in addition to expenditure changes related to Board orders, caseloads, program changes, and other key factors. This forecast provides the framework for setting initial budgetary priorities. Individual departments are responsible for developing departmental revenue estimates, i.e. for grant funding and fee reimbursements.

The CAO may provide departments with a "target" budget. This budget represents an estimate of total funding based on the department's prior year budget and any required adjustments. Unless related to a forecasted program change, the "target" budget does not include increases/decreases for the following categories of expenses:

(1) Budgeted positions
(2) Services and supplies
(3) Previously unapproved fixed assets
(4) Workers' compensation, retiree health benefits and long term disability programs

Departments may also submit a list of "critical needs" they deem as a priority to be funded as increases to the base budget. Departments are responsible for providing a detailed narrative of any changes to the prior year budget and the impact of such a change on service delivery and the monetary impact of the change.

During January to February of each year, each department is required to submit their budget request to the CAO for review and analysis. CAO analysts, along with the departmental staff, resolve various areas of the request and identify outstanding issues that may be discussed during the hearing between the CAO and the Department Head. These outstanding issues may include critical needs identified by the department. The departmental hearings with the CAO are generally held during February and March.

The approved changes to the budget are incorporated in the Proposed Budget for submission to the Board in April. Public hearings on the Proposed Budget are scheduled in May and the Board deliberates and adopts the budget in June. In September, after the fiscal year closes and the fund balance is determined, supplemental budget changes may be recommended for Board approval prior to the issuance of the County's Final Budget.

During the fiscal year, the departments and the CAO are responsible for monitoring and managing the budget. Departments are required, at a minimum, to submit a 5th month, 9th month and an 11th month budget status report to compare to the adopted budget and the latest adjusted budget. Adjustments to the budget can be accomplished with CAO approval if the adjustments are less than $250,000 per quarter and are within a budget unit. The Board delegated this authority to the CAO. All other adjustments require Board approval.

III. FINDINGS AND RECOMMENDATIONS

The scope of work set forth by the Auditor-Controller identified specific objectives for review. This section identifies the study team's findings and recommendations related to those objectives as they relate specifically to the Sheriff's budget review.

Finding 1: The study team found that the CAO fairly applied its budget instructions to the Sheriff's Department budget.

Finding 2: During the audit period, the Sheriff's budget did not accurately forecast actual expenditures by appropriation category, nor was the budget amended during the fiscal year to reflect actual expenditures, resulting in significant year end variances.

During the audit period, the Sheriff's budget consistently failed to accurately forecast actual expenditures within the correct appropriation category. The Sheriff's budget significantly understated its S&EB costs while overstating its S&S costs. This variance steadily increased during the audit period as shown below:

Fiscal Year	Over/(Under) Budget	Over/(Under)
FY1997/98	$5,172,370	($13,424,702)
FY1998/99	$9,454,432	($18,722,881)
FY1999/00	$27,844,417	($20,213,833)
FY2000/01	$85,251,908	($21,820,602)
FY2001/02	$61,515,415	($58,773,635)

In FY2000/01, the Sheriff overspent its budget by $25.3 million. The primary cause of this overage was a significant variance within its S&EB costs (as noted above). The Sheriff agreed to an Expenditure Plan to "repay" the $25.3 million (as well as an additional $20 million resulting from litigation settlement) over the next two fiscal years. The significant overage in FY2000/01 was symptomatic of two weaknesses within the CAO's budget process: First, the Sheriff's proposed budget did not accurately reflect anticipated expenditures within appropriation categories or within the level two budget units. And second, during a fiscal year when it became apparent that significant variances would occur, little or no corrective action was taken to amend the budget to reflect the expenditure trends.

Beginning in FY2002/03, the CAO and the Sheriff began a process to realign the Sheriff's budget to more accurately predict expenditures. This effort occurred primarily at the major appropriation category level to correct the variances within S&EB and S&S. Additionally, the CAO undertook a substantial position reconciliation effort in an attempt to better prepare and analyze the Sheriff's budget.

The CAO is responsible for ensuring that departmental budgets are accurate and reflective of future departmental spending. As part of this responsibility, the CAO sets standards on how the departments should develop and monitor their budget. Regardless of the efforts that the CAO may have taken, the audit results show that there has been a repeated weakness in the budget process to project future Sheriff expenditures, both at the major object level and at the level two budget. Rather than requiring the Sheriff to more accurately reflect S&EB and S&S expenses, it appears that the S&S budget was simply allowed to offset the overages occurring within the S&EB budget.

***Recommendation 1:* The CAO should work collaboratively with the Sheriff to ensure that their budget more accurately predicts actual expenses within the level two budget units (e.g., departmental bureaus, divisions, programs, etc.).**

The CAO and the Sheriff began a process to realign the Sheriff's budget in FY2002/03. The resulting budget corrected the imbalance that occurred within the major categories of S&EB and S&S. The CAO, however, must continue in future budget years to ensure that expenses are properly budgeted in the level two budget units.

As part of this effort, the CAO and the Sheriff must work to eliminate unfunded positions and over-hires in order to better reflect actual staffing levels. As is discussed more fully in Finding 3 below, past budgets have overstated the number of positions the Sheriff's department would financially be able to fill during the course of the fiscal year, resulting in an inaccurate estimate of actual staffing levels.

***Recommendation 2:* The CAO should continue its efforts to explicitly quantify and highlight the impacts of anticipated expense components of significant growth.**

The multi-year forecast provides an effective mechanism to anticipate the County's financial position over the mid-term (three years). The forecast is a multi-year revenue forecast as well as a projection of the cost increases associated with some program changes and personnel costs on the General Fund. The forecast specifically identifies the impact on the General Fund for cost increases. It is provided to the Board annually in March prior to release of the proposed budget.

The Budget and Operations Management Branch of the CAO prepares the annual multi-year budget forecast. This forecast is effective at providing an annual and mid-term context for annual budget deliberations. It is also an essential tool for providing the starting point for budget discussions on a countywide basis. The forecast includes an estimation of the impact of cost increases, which will be included in the baseline budget such as:

- Board orders
- Program changes
- Negotiated Countywide Salaries and Employee Benefits for employees.

Since the 2002/03 forecast, the CAO has quantified the impact of other significant cost increases on the County for other unfunded changes such as retiree health and workers' compensation. It is important to quantify the impact because of: (1) magnitude of the growth in these cost items; (2) need to promote countywide efforts to address these growing expenses; and, (3) understand the impact on department budgets.

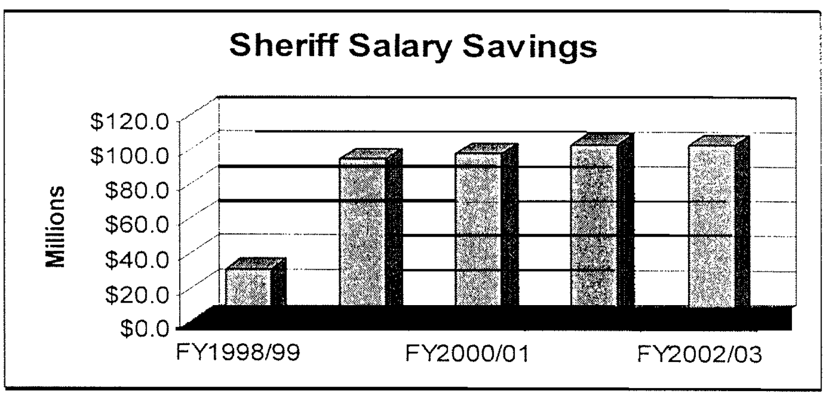
CAO efforts to highlight these growing cost items should be commended and continued. While historically the impact of workers' compensation and retiree health benefits has only been included in internal document versions of the multi-year forecast, we recommend that this information be included in the full report presented to the Board for the reasons highlighted above. (It should be noted that the departments are provided with an update of the current status of the workers' compensation as well as a projected cost for the following year every December).

It is our understanding that these additional cost factors will be quantified and highlighted in the FY2003/04 proposed budget and included in the next multi-year forecast. The CAO should continue these efforts and should be recognized for its efforts made to date.

Finding 3: During the audit period, the budgets for the Sheriff and District Attorney overstated the number of positions expected to be filled during the course of the fiscal year. The salary savings component of the budgets were artificially inflated to balance S&EB costs.

Salary savings is intended to capture the cost savings associated with predictable salary adjustments (e.g., step increases) and routine vacancies. In the case of the Sheriff's Department and the District Attorney's Office, salary savings has been artificially increased in order to offset an unfinanced increase in budgeted positions. The result has been that both the Sheriff and the District Attorney held certain positions "permanently" vacant to achieve their salary savings target.[2]

Over the past five years, the salary savings component of the Sheriff's S&EB costs has risen dramatically, as shown below.



This salary savings increase occurred at the same time as significant increases in budgeted positions. The CAO and the Sheriff used the large salary savings to

[2] It should be noted that the Sheriff's Department must maintain fixed post positions which, if vacant, must still be covered on an overtime basis and do require some adjustment to salary savings.

offset a portion of the increase in adopted positions, resulting in a larger vacancy rate within the department.

A similar strategy was also employed for the District Attorney's budget. From FY1994/95 through FY2001/02, the District Attorney increased its budgeted positions by 491. During the same period, the District Attorney's salary savings percentage grew from 3% in FY1994/95 to over 13% in FY2002/03. While some of the increased salary savings may have been required to cover additional expenses associated with workers' compensation and other employee benefit programs, the vast increase in the salary savings resulted from the need to offset the large position increase.

As part of developing a department's S&EB budget, the County has adopted a strategy of reducing the gross S&EB budget by a factor equivalent to predicted spending (salary savings). The gross S&EB budget represents the total cost of maintaining the budgeted positions assuming the top step salary for each position, any negotiated pay raises and no vacancies. The salary savings is obtained by reducing the gross S&EB figure by:

- The amount of savings based on a reduction of expenditures for those employees not receiving the top step salary
- The cost of mid year raises from existing positions
- The expected vacancy resulting from attrition, hiring delays or other factors

The salary savings figure is deducted from the gross S&EB costs, resulting in the net budgeted S&EB.

The first two factors of salary savings are objective estimates of the amount saved based on existing payroll data. The final factor, however, represents a projection of the anticipated vacancy factor.

<u>Recommendation 3</u>: The CAO should consider applying a more objective methodology for calculating salary savings for the Sheriff's Department and the District Attorney's Office, and mandate that departments more accurately state budgeted positions they reasonably anticipate filling during the budget year.

As discussed above, the Sheriff and the District Attorney budgets have routinely overestimated the salary savings component in determining S&EB which has resulted in the Sheriff and the District Attorney maintaining artificially inflated vacancy rates.

The CAO should implement two procedures to ensure that salary savings serves its intended purpose:

- The CAO should require that the vacancy factor element of salary savings be based on historical vacancy data and objective hiring delay factors, and

- The CAO and the departments should identify and eliminate positions that have been historically held vacant to "fund" the inflated salary savings.

This approach serves two purposes. First, it will restore salary savings to its intended purpose, i.e., to predict the amount of unused salaries and benefits associated with salary adjustments and routine vacancies. An objective measure of this savings factor will eliminate the temptation to utilize salary savings in the short term to gain adopted positions in the long term. Second, by eliminating historically vacant positions, departments, the CAO and the Board will have a more accurate picture of the department's actual position needs and utilization.

Finding 4: During the audit period, the CAO used a baseline budget approach in developing the departmental budgets. In light of continuing economic instability, this approach may no longer be compatible to address future financial realities.

The CAO requires that departmental budgets be prepared using a baseline budget approach. Departments develop their budget using the prior year budget plus the additional costs associated with programmed expenditures such as negotiated S&EB increases. Additional costs associated with program expansion or service delivery changes must be requested and are considered separately as a "critical need."

Current economic instability at both the federal and State levels is creating significant financial challenges for the County. In addition, some key County revenue sources are slowing down or actually declining. In this environment, it is becoming increasingly difficult to continue to fund programs and services at historical levels without restructuring County expenditures. The baseline budget model currently being used by the CAO makes it difficult for the County to systematically identify and implement program restructuring.

***Recommendation 4*: The CAO should continue its efforts to more fully integrate and align strategic planning and performance measurement within the budget process.**

The CAO should work to build a more strategic budget process that closely aligns strategic planning and performance measurement to resource decisions. The County began to move in the direction of integrating performance measures with the budget process starting with the departments participating in the Children's budget. Given that the County needs to operate within a number of mandates, further analysis should be performed to fully integrate performance measurement in the budget process. The current focus is to use performance measures for strategic financing decisions and as a tool to evaluate the quality of programs, and assess ways to change the method of service delivery to improve results.

The budget process continues to operate outside of this framework and is relying on incremental budgeting (or base budgeting) without critically examining the cost of programmatic base assumptions. Government entities that have fully embraced strategic planning and performance measurement have restructured the traditional budget process to implement certain aspects of other budgeting approaches. For example, some entities have adopted a rotating cycle of budgeting that requires individual departments or programs to reevaluate their budget every three to five years. This type of approach allows those entities to more fully understand the full or incremental cost of strategic priorities by linking resource allocations to targets of performance.

<u>Recommendation 5</u>: The CAO should evaluate the effect of changes to the revenue management strategies for the expenditure of Proposition 172 funds.

The County should consider alternatives being incorporated by other counties to enhance revenue management strategies for the use of Proposition 172 funds. Two of the peer counties interviewed pursuant to this study have implemented cost management incentives for utilizing Proposition 172 funds.

In Orange County, recipient departments' expenditures are credited against Proposition 172 funds only after all other budgeted revenue sources have been exhausted. Any fund balance at the end of the fiscal year is transferred to a Proposition 172 reserve account for use by the recipient department. The Sheriff in Orange County is able to use this reserve account to offset revenue shortfalls in underperforming fiscal years or as a funding source for capital projects.

A similar approach is used in San Diego County. Excess Proposition 172 funds (any surplus funds in excess of those forecasted in the budget) are set aside in a reserve account to be used by the recipient departments for one-time expenditures. The approach taken by San Diego provides a built-in capital reserve account that benefits the recipient departments.

Any change to the Proposition 172 allocation or how those monies are expended would require further legal review and would likely require the Board to adopt a further resolution to implementing any change.

IV. NEXT STEPS

This report was completed consistent with the scope of work to provide a written interim report on findings and recommendations in regards to the CAO Budget Methods and Practices. The final report will address:

- The above findings and recommendations related to the CAO budget practices as well as any additional findings made during the remainder of this project
- The internal budget practices of the Sheriff Department
- An evaluation of the Sheriff's budget performance, and
- The contract city billing model utilized by the Sheriff to obtain reimbursement for contracted services

The recommendations regarding improving the budget development and monitoring process may be refined or expanded to reflect subsequent information presented as part of the Sheriff Department review. Additionally, during this next phase we will address in greater detail recommendations for improving the working relationship between the CAO and Sheriff Department to improve overall budget development, control, and monitoring.

Appendix A

The following is a list of contacts made to date by the study team in relation to the interim report. Meetings were also held with the Sheriff's Department as part of the overall study and were incorporated within this report. A full list of meetings with Sheriff Department staff will be incorporated in the final report.

- Rochelle Goff, Los Angeles County Chief Administrative Office, Public Safety Team
- Brian Mahan, Los Angeles County Chief Administrative Office, Public Safety Team
- Yolanda Reyes, Los Angeles County Chief Administrative Office, Public Safety Team
- Sid Kikkawa, Los Angeles County Chief Administrative Office, Finance Division
- Jackie White, Los Angeles County Chief Administrative Office, Finance Division
- Amy Clarke, Los Angeles County Chief Administrative Office, Finance Division
- John Naimo, Los Angeles County Auditor-Controller's Office
- Joseph Munzo, Los Angeles County District Attorney's Office
- John Paccione, Los Angeles County District Attorney's Office
- Valerie Clay, County of San Bernardino, Deputy Administrative Officer
- Jill Serrano, County of San Diego, Finance Director for Public Safety
- Frank Kim, County of Orange, Chief Administrative Office, Budget Analyst

County of Los Angeles
CHIEF ADMINISTRATIVE OFFICE
713 KENNETH HAHN HALL OF ADMINISTRATION • LOS ANGELES, CALIFORNIA 90012
(213) 974-1101
http://cao.co.la.ca.us

DAVID E. JANSSEN
Chief Administrative Officer

May 9, 2003

To: Supervisor Yvonne Brathwaite Burke, Chair
Supervisor Gloria Molina
Supervisor Zev Yaroslavsky
Supervisor Don Knabe
Supervisor Michael D. Antonovich

From: David E. Janssen
Chief Administrative Officer

AUDIT RESPONSE - 2002-03 SHERIFF'S DEPARTMENT BUDGET STUDY INTERIM REPORT

On March 14, 2003, as part of the 2002-03 Sheriff's Department Budget Study, Thompson, Cobb, Bazilio, and Associates, PC (TCBA) and Altmayer Consulting, Inc. submitted an interim report following a review of the Chief Administrative Office's (CAO) budget methods and practices (attachment). This memorandum provides our response to the report. In general, while we concur with the findings and recommendations, we have provided additional clarification where appropriate.

Background

On May 21, 2002, on motion of Supervisor Antonovich, your Board instructed the Auditor-Controller (Auditor) to retain an outside accounting firm to conduct an audit of the County's budgeting practices as they relate to the Sheriff's Department and the use and computation of salary savings in the Sheriff's and the District Attorney's (DA) budgets. On December 12, 2002, the Auditor entered into a project agreement with TCBA to conduct the 2002-03 Sheriff's Budget Study. Study objectives included the review of: 1) the budget methods and practices of the CAO in general and in particular as they relate to the Sheriff, including the CAO's year-to-year consistency in applying budget methods and practices as they relate to the Sheriff; 2) the methods and practices of the Sheriff in developing annual budgets; 3) the Sheriff's overall budget performance for the past five fiscal years; and 4) the contract city billing model developed in the early 1970s.

<u>CAO Budget Methods and Practices - Findings and Recommendations</u>

Finding 1: *The study team found that the CAO fairly applied its Budget Instructions in developing the Sheriff's Department Budget.*

Finding 2: *During the audit period, the Sheriff's Department did not accurately forecast actual expenditures by appropriation category, nor was the budget amended during the fiscal year to reflect actual expenditures, resulting in year end variances.*

Recommendation 1: *The CAO should work collaboratively with the Sheriff to ensure that their budget more accurately predicts actual expenses within level two budget units.*

CAO analysts routinely collaborate with departments to better understand and address expenditure fluctuations to ensure departments operate within their adopted budgets. However, as an elected official the Sheriff may reallocate budgeted resources, as he deems appropriate, to ensure effective law enforcement services are provided to County residents. Mid-year reallocations of funding result in variances between actual expenditures and budget. The audit team attributed these variances to a lack of oversight by the CAO. However, both the CAO and the Auditor were aware of the variances which were reported to your Board as part of the normal budget status reporting process. As a result, while the Sheriff's level two budget units are monitored and tracked throughout the year by the CAO, the Sheriff's expenditures are controlled to the bottom line. We believe it is inappropriate to annually realign the Sheriff's budget to address prior-year spending patterns due to unanticipated or one-time only requirements. However, we will continue to work with the Sheriff's Department to realign the level two budget units, where feasible, to more accurately reflect anticipated requirements and to process mid-year appropriation adjustments when feasible.

Recommendation 2: *The CAO should continue its efforts to explicitly quantify and highlight the impacts of anticipated expense components of significant growth.*

The multi-year budget forecast is an essential tool used in determining the impact significant cost increases, unfunded liabilities, and revenue fluctuations will have on the County's General Fund. We will continue to improve the methodologies used to develop the multi-year forecast including the projection of areas of significant growth such as worker's compensation and retiree health.

Finding 3: *During the audit period, the budgets for the Sheriff and District Attorney overstated the number of positions expected to be filled during the course of the fiscal year. The salary savings component of the budgets were artificially inflated to balance S&EB costs.*

Recommendation 3: *The CAO should adopt a more objective methodology for calculating salary savings and mandate that departments more accurately state budgeted positions they reasonably anticipate filling during the budget year.*

On February 5, 2002, your Board instructed the CAO to review the issue of salary savings for the DA and Sheriff and to report back with recommendations on how to reduce each Department's salary savings requirement. The CAO issued a report on February 12, 2002, which indicated that salary savings had been used in the past as a negotiating tool between the CAO and departments. Specifically, in the case of the Sheriff's Department, the CAO and the Sheriff mutually agreed to adjust salary savings to add budgeted positions to reconcile to actual staffing. In the Sheriff's 2002-03 and 2003-04 Proposed Budgets, vacant budgeted positions were eliminated to bring the Sheriff's salary savings into alignment.

Finding 4: *During the audit period, the CAO used a baseline budget approach in developing departmental budgets. In light of continuing economic instability, this approach may no longer be compatible to address future financial realities.*

Recommendation 4: *The CAO should continue its efforts to more fully integrate and align strategic planning and performance measurement within the budget process.*

As the lead Department in the development and implementation of the County's Vision and long-term strategic planning process, the CAO began to incorporate the strategic plan into the budgeting process during fiscal year 2001-02. All program changes reflected in the Proposed Budget include a reference to specific strategic plan goals and objectives. In addition, CAO budget analysts have been working with departments to develop, implement, and include relevant performance measures which tie directly to the strategic plan and effectively measure departmental efforts to achieve desired program outcomes through establishment of realistic service delivery standards. An intensive effort is underway with the Guiding Coalition, CAO and consultants to work with all departments to refine their performance measures to be included in the 2004-05 Proposed Budget in order to better integrate the Strategic Planning and Performance Measures process with the County budget.

Recommendation 5: *The CAO should evaluate the effect of changes to the revenue management strategies for the expenditure of Proposition 172 funds.*

The consultant's report suggests the County should consider placing Proposition 172 revenues into a trust fund for exclusive use by the Sheriff and DA. The purpose of doing so would be to ensure that over realized revenue is preserved in years where the actual amount of revenue received exceeds the budgeted amount.

Currently, the Auditor posts all Proposition 172 revenue directly to the Sheriff's and DA's budgets. As reflected in the 2003-04 Proposed Budget, Proposition 172 revenues continue to decline, so surplus revenue does not exist. Further, the General Fund absorbed this reduction rather than forcing the Sheriff or DA to take a curtailment.

In the future, should a surplus be realized, the CAO will consider and recommend implementation of revenue management strategies for the use of surplus Proposition 172 revenue for Board policy consideration.

Summary

We will continue to refine CAO budget methods and practices to ensure implementation of Board policies where appropriate. We appreciate the opportunity to participate in the study of the County's budget process and to respond to the interim report. Please let me know if you have any questions or your staff may contact Debbie Lizzari at (213) 974-6872.

DEJ:SRB:DL
RG:BAM:ljp

Attachment

c: Auditor-Controller

audit.bm

STEVE COOLEY
LOS ANGELES COUNTY DISTRICT ATTORNEY

18000 CRIMINAL COURTS BUILDING 210 WEST TEMPLE STREET LOS ANGELES, CA 90012-3210 (213) 974-3501

May 9, 2003

Mr. J. Tyler McCauley
Auditor-Controller
525 Kenneth Hahn Hall of Administration
500 West Temple Street
Los Angeles, California 90012

Attention: Mr. Brian Henricks

Dear Mr. McCauley:

Response to Audit Report Recommendation Number 3, Finding Number 3: CAO Budget Process Review TCBA/Altmeyer Consulting, Inc.

The suggestion to eliminate the vacant budget positions as long-term vacancies which are no longer needed is a simplistic approach that is entirely insensitive to the facts and causal factors that contributed to the situation. This is tantamount to a parental decision to cut off a child's nose because there are insufficient family funds to pay for cosmetic surgery to correct a deformity. The child still needs his nose!

The District Attorney has an inordinately high salary savings requirement for two primary reasons which have been imposed on the Department's budget through arbitrary budget formulation policies of the Chief Administrative Office , undertaken as an expedient means to reduce the net cost of the Department.

Although the CAO will insist that the historic annual decisions to increase the salary savings were mutually agreed to by the District Attorney's Office, this is disingenuous.

The CAO has dealt with the Department in a one-sided manner issuing "Results-based bottom line financial limits" to the Department, and then simply asking, "How do you want to handle the reduced net availability of funds?" This is not a mutually reached accord.

With one notable exception, the CAO has ignored the Departments' annual requests to reduce the salary savings requirement, citing no available funds to "buy down" the 13 percent requirement. In formulation of the 2001-2002 budget, the CAO added a one-time increment of $1,000,000 to assist in reduction of the salary savings requirement. The $1,000,000 increase in Net County cost to reduce $1,000,000 in the salary savings was very modest, considering that the salary savings requirement was hovering in the area of $23,000,000.

The recommendation on page 10 of the Audit Report that states… "the CAO should consider applying a more objective methodology for calculating salary savings for the Sheriff's Department and the District Attorney's Office, and mandate that Departments more accurately state budgeted positions they reasonably anticipate filling during the budget year," and leading to the following recommended policies:

--The CAO should require that the vacancy factor element of salary savings be based on a historic vacancy data, and objective hiring delay factors, and

--The CAO and the Departments should identify and eliminate positions that have been historically held vacant to "fund" the inflated salary savings.

These two foregoing suggestions are not reflective of thorough knowledge of the facts concerning the County's present operating policies.

You don't need to hire a consultant to conclude that if you historically hold back 13 percent of the Department's salary funds, some long-term vacancies will result. The vacancies <u>are</u> the result of the policy to withhold funds and keep the Net County cost of the Department from increasing commensurate with the true funding requirements of the Department.

Likewise, the writer of the recommendation ignores the fact that the County has imposed a modified hiring freeze on County Departments that prevents Department Heads from staffing positions unless certain percentage vacancy thresholds are reached. This also contributes to the existence of some long-term vacancies.

To suggest in recommendation number 3 that, "Departments' more accurately state budgeted positions they reasonably anticipate filling during the budget year," is also reflective of poor understanding of the District Attorney's long-term communication with the Board and the CAO as to the needs and budget requirements of the Department. Letters outlining the annual needs are well documented and publicly posted on the County's website, as well as having been hand delivered to the CAO, each Board member's office, the Clerk of the Board of Supervisors; and, having been entered into the record each year of the Board's deliberations on the recommended budget.

To simplistically suggest, in light of all the foregoing factors, that the long-term vacancies be summarily excised from the Department's budget to expediently resolve the embarrassment of a long termed failed policy of budget formulation on the part of County staff, is very wrong.

If you cut those positions, you eliminate general fund positions that were mortgaged to staff underfunded grants!

This Department does not dispute the need for a salary savings which reflects the fifth step variance of incumbent staff salaries vs. the top step value of salaries, nor the need for a salary savings to reflect the normal expectation of vacancies. We estimate this combined factor to be approximately six percent of the Department's salary budget, not the current 13 percent factor.

This Department does, however, dispute the practices which in the past contributed to the inordinate growth of the salary savings requirement.

Among these are underfunding newly acquired grant programs in salaries and employee benefits, while budgeting 100 percent of the expected revenues of the same programs. This causes the Department to fill the grant-funded positions on a mid-year implementation schedule with County general funded personnel from line operations, with no financial adjustment in the subsequent program years to address the first year's implementation underfunding.

This causes long-term vacancies to occur in line operations, in order to maintain full staffing in grant programs and to guarantee the grant-funded revenue stream. This technique was used repeatedly in the early and mid-1990's and has contributed greatly to both the problems of long-term vacancy, and high salary savings requirement.

The Department has been required to finance each year 100 percent of the inflationary increase in Worker's Compensation and Retiree Health Insurance. The increases have been paid for by transferring current salary account funds to pay for the inflationary benefit increases. This also contributes to an increase in long-term vacancies, since the Department can not afford to fill all formerly filled positions.

It is this Department's observation that the audit undertaken by the contract auditors has been relatively thorough, but the reporting out has been delayed due to negotiations behind the scenes from which we have been excluded.

Some change has resulted, however, by the on-going audit of budget formulation practices, as evidenced by the CAO's budget transmittal letter of April 15, 2003 which now for the first time reflects the causal factors of "County Structural Deficit" and "Absorption of Cost Increases" as factors which contribute to curtailments in Department's such as the District Attorney's Office.

In summary, the consultants' report does not thoroughly address this Department's consistent position on salary savings, but instead still shys away from a financial solution.

Very truly yours,

STEVE COOLEY
District Attorney

tla